It is tempting for an economist to invoke Nancy Reagan’s dictum when dealing with trade protection: “just say no.” On analytical grounds, it is hard to see why structural change because of trade should be singled out for special policy treatment. Moreover, protection, particularly with quotas, is an inappropriate policy instrument for achieving the purposes to which it is generally put. It is inefficient, its costs are not transparent and it may even be counterproductive when used to save jobs or improve competitiveness. If, for example, quota protection encourages domestic monopolists to reduce output, it could lower employment. (See Clifford Winston and Associates, 1987, for an example.) Similarly, increasing foreign rents, quotas could reduce the long-run competitiveness of domestic industry.

Nonetheless, the pure free trader must deal with political reality. Trade is singled out as a source of change in the U.S. Constitution. While the Constitution prohibits interference with interstate commerce it expressly provides Congress the authority (and thus exposes it to the political pressures) to regulate international commerce. No matter how firm their ideological commitment to open markets, all U.S. administrations have found the political pressures for protection irresistible. According to William Niskanen, who served on President Reagan’s Council of Economic Advisers, President Reagan, despite his free trade rhetoric, has been the most protectionist U.S. president since Herbert Hoover. Moreover, when granting protection, the Reagan Administration has generally used quotas rather than tariffs. Even if President-elect Bush can resist pleas for new protection—he has already agreed to extending steel quotas in 1989—he still needs a strategy for unwinding existing quota protection in an era of scarce budgetary resources. In this paper, therefore, I will discuss U.S. programs that provide protection and consider how protection could be improved and removed.

I. Existing Programs

The United States has two major routes to protection. The escape clause provides a legal route that has been associated with considerable adjustment and has proved to be temporary. The provision of quota protection by the president and/or Congress through legislation or negotiation, is a second, more political route that has been associated with hidden barriers which tend to be permanent. Let us consider the experience with each route and explain why the second, less desirable route has been used so frequently.

The Escape Clause. Section 201 of the Trade Act of 1974, the escape clause, provides legislators with a safety valve for diverting protectionist pleas. It allows domestic industries to receive temporary protection from imports when they can 1) prove to the U.S. International Trade Commission (ITC) that imports threaten or cause them serious economic injury, and 2) persuade the president that relief is consistent with the na-
tional interest. Paralleled by Article XIX of the General Agreement on Tariffs and Trade (GATT), the provisions of the U.S. escape clause have been used since 1947 to protect more than thirty industries, ranging from the integrated steel industry to manufacturers of nuts and bolts. In principle, the escape clause is the major route to protection. In practice, it has become a secondary road.

The escape clause law has performed reasonably well where it has been applied. Relief provided under the escape clause has been temporary. By statute, the president could grant protection for a period no longer than five years; thereafter, domestic interests had to prove that renewed protection was merited. In fact, only two of the more than thirty industries that have won escape clause relief (specialty steel and roofing materials) remained protected in 1988. Moreover, according to Gary Hufbauer et al. (1986), protection under the escape clause has been associated with considerable adjustment, most of which has occurred through down-sizing.

Relief under the provisions of the escape clause has not been easy to obtain. Only about 6 out of 10 domestic petitioners for relief since 1975 have been able to prove their case before the ITC, and only 1 out of 4 of the 201 petitions filed since 1975 has ultimately resulted in the president providing import relief. Econometric studies (such as Robert Baldwin, 1985) indicate ITC decisions have been largely determined on their economic merits, relatively free from political pressures.

Nevertheless, the escape clause has three major flaws. As estimated for example by Hufbauer et al., such protection is costly; escape clause protection has taken the less desirable form of quotas as well as tariffs; and the denial of any aid by the president to more than half the industries that proved their case before the ITC has emerged as a problem. With relief so uncertain, even in cases such as footwear in 1986 where injury is demonstrated, lawmakers have been tempted to legislate costly quantitative import restrictions.

Special Protection. Several, typically large industries with political clout, have obtained special protection from the president or the Congress. When granted, such protection has generally taken the form of legislated quotas or voluntary restraint arrangements (VRAs) with foreign exporters. Recent examples include President Reagan's use of VRAs to limit imports of automobiles, carbon steel, and machine tools. In addition, statutory frameworks have been used to place quantitative restraints on textiles and apparel imports, and quotas on dairy, peanut, cotton, and sugar imports.

Protection obtained in this manner does not require meeting any particular standard or criterion—not even one as vague as "serious injury." Such protection has tended to be permanent and unrelated to the current fortunes of the industry. As noted by Hufbauer and Howard Rosen (1986), import quotas have been applied to sugar, peanuts, and dairy products in the United States for more than thirty years. Domestic shipbuilders have been shielded from foreign competition in coastal traffic since 1920. Most costly of all, in terms of higher prices paid by consumers, have been the limits on textile and apparel imports, set through quotas negotiated bilaterally under the auspices of the Multifiber Arrangement.

If industries are to be protected, most economists and the GATT would prefer tariffs over quotas. But quotas have greater political appeal (Arve Hillman and W. Heinrich Ursprung, 1988, and James Cassing and Hillman, 1985). The costs of quotas are hidden. If foreigners can be made to comply "voluntarily," the home country avoids explicitly violating the letter of the GATT which has bound tariff rates. Trade officials sometimes suggest that discriminatory VRAs do less damage than global quotas or tariffs. Indeed, as Baldwin (1982) has argued, where transshipment through third countries is possible or where close substitutes are available in other countries, VRAs may be circumvented or ineffective. But experience (with textiles and steel, for example) has shown that where import pressures are diverted, the measures are soon extended to (and by) other countries. Quotas appeal to domestic producers, particularly those with some monopoly power, because, unlike tar-
iffs, they may reduce demand elasticities and thus raise optimal prices. Foreign firms also like quotas, since they are directly compensated with higher profit margins. Under the GATT, the country (but not the industry) hurt by new protection is supposed to receive compensation.

II. Future Policy

The new administration needs creative approaches to provide a plausible alternative to new and embedded cases of quantitative protection. In an era of budgetary stringency, the best advice of trade theory, to use subsidies rather than tariffs, is not always practical. A second-best approach is to use only self-liquidating tariffs where protection is unavoidable and to use the revenues from such tariffs to compensate those hurt by imports and/or the removal of existing quotas.

The escape clause should serve as the center of the relief program for all claimants. Similarly, only countervailing duties, rather than VRAs or cartels, should be used in response to dumping and subsidies. The tilt toward this form of relief can be achieved by making other forms of protection less attractive and by making the escape clause more attractive. Because the political appeal of VRAs is considerable, the government should tie its hands to prevent the use of such measures by amending the antitrust laws. Following the proposals of Jan Tumlir (1985), the Sherman Act should be extended to prohibit the foreign cartels (even those blessed by foreign governments) necessary to make VRAs work. A weaker measure would be to require estimates (by the Office of Management and Budget) of the tariff and revenues foregone by any new quota measures.

The 1988 Trade Act makes the escape clause more attractive by easing eligibility standards and limiting (but not removing) presidential discretion in denying relief. The next president should enhance this attractiveness. In instances where the ITC recommends action but the president does not feel protection is warranted, he should automatically extend two alternative forms of relief.

First, mergers of firms should be assessed under liberalized standards. These standards would recognize the full extent of discipline exerted by foreign producers on U.S. firms. Second, an improved trade adjustment assistance (TAA) program should be extended to displaced workers from industries found by the ITC to be injured by trade.

In cases where the president believes temporary protection is warranted, he should use only declining tariffs. The model would be the successful experience of the Harley-Davidson company. In addition, as part of the current Multilateral Trade Negotiations, the administration should avoid agreeing to a new Safeguards code that condones discriminatory protection. Instead, it should press for a revised code which permits, once injury has been found by an open (or GATT) judicial hearing, the temporary use of nondiscriminatory declining tariffs, without requiring compensation to trading partners.

Improving Trade Adjustment Assistance. The TAA program provides the president with a means of showing concern for the adverse impact of imports without providing trade protection. But it has not provided effective compensation or encouraged adjustment. All workers receive similar benefits so that levels of assistance provided to displaced workers have not reflected the degree of injury they may have suffered because of import competition. Moreover, the form in which assistance has been provided (in effect, extensions of unemployment compensation) does not motivate displaced workers to find new jobs. Trade-adjustment payments might include, in addition to extended unemployment benefits, an earnings insurance component that compensates displaced workers once they accept new employment. Indeed, this proposal is part of the 1988 Trade Act in the form of a pilot project.

Payments would equal a fixed percentage of any erosion in earnings for a particular period of time. This approach would compensate workers for some of their loss of specific human capital—as revealed by subsequent earnings. It would not compensate them fully, however, to maintain some form of copayment to limit moral hazard prob-
lems. The proportion of income replaced would decline gradually and could reflect the age and experience of individual workers. By providing extra compensation to workers after they find new employment, the proposal would give them an incentive to adjust. Rather than remain idle in the hope of reemployment, workers would be more likely to accept jobs paying lower wages but offering new career opportunities, training programs and chances to build seniority.

**Removing Existing Protection.** The United States should convert all current VRAs and quotas into nondiscriminatory tariffs that decline over an extended period of time (see C. Fred Bergsten et al., 1987). The revenues raised from conversion could be used to fund a trade-adjustment program (Hufbauer-Rosen) and to provide compensation to foreign exporters currently enjoying quota rents.

In competitive industries, “tariffication” could proceed in two steps. First, existing quotas (and VRAs) would be globalized and auctioned. For some time, therefore, the domestic industry would receive the same amount of protection it obtains currently, but the globalization of current quotas would afford efficiency gains by allowing a redistribution of imports among foreign firms. Later, tariffs would be set at the rates determined by the final auction of quota rights. Thereafter they would be phased down and eliminated over fairly long periods of time. As Kala Krishna (1988) has pointed out, however, in industries where foreign exporters or domestic distributors have monopoly power, monopolists could reduce auction quota revenues to zero. In these cases, current quotas should be immediately converted into tariffs.

In some cases, in particular where the United States is a small purchaser on the world market, foreign exporters need not be compensated. In other cases, however, they could be explicitly compensated by preferential allocation of transferable quotas, tariff-rate quotas (Robert Feenstra and Tracy Lewis, 1988, and Feenstra, 1988) or direct payments.

This proposal is not without problems. There is some danger that Congress could become hooked on the tariff revenues. For-
for labor (or management) in such arrangements? Yet these are precisely the industries that have the political clout to obtain special protection.

Thus far, the U.S. experience with conditionality has not been particularly successful. In 1984, for the first time Congress imposed conditions for trade relief for the steel industry. As a condition for continuing any bilateral import restraint arrangements, the president had to certify each year that the eight major American steel companies were reinvesting all their net cash flow in the steel business. The experience with the steel industry demonstrates some of the pitfalls of this approach. Forcing all steel companies to invest in an industry plagued by excess capacity is inefficient. The commitment by President-elect Bush in the election to renew steel VRAs in 1989 suggests conditionality has had little impact in making protection less permanent. The recent finding that simply holding financial instruments meets the investment conditions points to the problems in making conditions precise.

REFERENCES


